Let’s Talk Business

Let's Talk Business: The Economic Impact of Brexit

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The debate on the UK's membership of the EU has been ongoing for months, with the renegotiation and referendum still to come, writes ***Mechthild Herzog****. She surveys key sectors of British business to assess the impact of EU exit on their industries and their arguments around EU membership. She suggests that, while business traditionally keeps itself out of the political limelight, the perceived importance of the issue may bring some companies to more publicly articulate their views on the EU.*

If Britain Leaves the EU, We Leave Britain: The Finance Sector

For financial companies, the choice seems clear enough. A report commissioned by the City of London Corporation states that if the UK remains in the EU, London's financial sector could grow by more than a third, with a 10 per cent increase in employment over the next decade. If it leaves the EU, as argued by Open Europe, not only will the UK's financial sector experience high disruption in the immediate post-Brexit future, but the chances are slim that the UK could negotiate similar terms of access with the EU as it has now.

It is therefore little surprise that a large number of finance companies have been developing contingency plans, among them Goldman Sachs, HSBC, Bank of America Merrill Lynch, JPMorgan, Citigroup, Morgan Stanley and Deutsche Bank. Over 250 banks are currently headquartered in London – in large part *because* the UK is part of the EU.

Absent EU membership, the City of London would not of course be cut off from European and global markets. However, it would find it difficult to remain on a par with financial hubs like Frankfurt, Paris or even Dublin, all of which have been suggested as potential new locations for banks and financial actors, large and small.

Yet this is only one side of the story. Equally ardent voices in finance oppose EU membership. First and foremost, they demand less EU red tape. In June, Business for Britain, an advocacy group chaired by former PA Consulting Group Executive Chairman Jon Moynihan, published a report called *Change or Go* – the title says it all.

Its requests are strikingly similar to the renegotiation demands Prime Minister David Cameron finally presented in November. The report argues that the financial sector would suffer from the imposition of further European regulation, which it describes as 'extremely expensive and damaging'.

It suggests that EU membership could only be countenanced if the UK were given a general national veto; full control over social and employment laws, and migration policy; an exemption from the commitment to 'ever closer union'; and opt-outs from burdensome regulation on business. The study concludes by asserting that '...the UK – as the world's fifth largest economy – has nothing to fear from [a Leave] vote and, indeed, much to gain.'

In terms of the potential exodus of big banks and big business, the picture is also divided. Neither Frankfurt nor Paris, for instance, could immediately take over the central and indeed historic role of London as a global financial centre. Lack of sufficient office space for one would mean that banks would have to pre-let or buy a site before knowing the result of the EU referendum, in order to be able to move headquarters in time.

Whether such drastic moves become necessary depend not simply on a 'Remain' or 'Leave' vote in the referendum, but on the nature of the renegotiation, the consequences of the implementation of the deal in the event of 'Remain' and the overall impact in the event of 'Leave'. Alternatives to EU membership, such as a deal to remain within the European Economic Area (EEA), could mitigate circumstances. As an EEA member, the UK would for instance retain 'passporting rights', allowing businesses to continue to operate across the EU.

As Nobel laureate Nils Bohr observed, 'Prediction is very difficult, especially if it's about the future'. Sketching out possible scenarios on either side of the argument is a frustrating task. While the pro-EU lobby of financial actors is currently larger and louder, with clearer and more substantive points than the pro-Brexit group, its voice might not necessarily persuade the British public to vote their way.

On the one hand, as the then Liberal Democrat MEP Sharon Bowles argued in April 2014: 'Bankers are so hated by the public at large that saying the bankers want us to stay in Europe might lead the public to say, "Well then, I'm coming out."' On the other hand, the financial sector might well be deeply affected by Brexit – with enough influence to tip the balance.

The Ultimate Uninsurable: The Insurance Sector

The insurance industry also perceives Brexit as a considerable threat, largely because it might suffer disruptions which are not only short-term, but permanent and fragmenting. Unsurprisingly, the majority of insurance sector representatives strongly advocate the UK retaining EU membership. Gerry Grimstone, Chairman of the Edinburgh-headquartered insurer Standard Life, set the tone in this respect, describing a Brexit as 'disastrous for London and the UK'.

Insurers, themselves in the business of managing risk, find themselves in a position in which the risk to their overall sector remains at present unmanageable. UK-based insurers are fearful of losing the strong position they currently hold, were they to become unable to sell their policies in the rest of Europe at the same pre-Brexit prices and conditions.

Post-Brexit conditions might also deter overseas companies from opening offices in the UK. The impact of leaving the EU could affect not only current business strategies, but undo the years of work spent on a common regulatory framework, including agreements on the amount of capital EU insurers must hold to establish and operate their businesses.

At present, Brexit would leave British insurers with two choices: open costly subsidiaries within the EU and report to local regulators, or wind up their business with key European markets altogether. As with the financial sector, EU membership allows both British and third-country businesses to have a company based in only one EU Member State that can operate in all twenty-eight.

Even if Britain were to remain a member of the EEA, which would in principle allow British insurers to retain their 'passporting' rights, they would still lose the power to bargain on key sectoral issues, including regulation and failsafes, despite being required to continue to comply with them.

A report by Standard & Poor's in June, however, injected a degree of calm, or at least pragmatism, saying that Brexit would be 'costly but not game-changing' for British insurers. It suggested that the sector was far more reliant on trade with other countries, like the US, than with the EU. A series in the *Financial Times* went further, suggesting in February that due to the very domestic character of Europe's insurance market, the UK's insurance industry would experience 'little direct or immediate impact'.

From this perspective, it is simply too early and ambiguous for insurers to feel compelled to develop contingency plans, including moving their headquarters from the UK. Huw Evans, Chief Executive of the Association of British Insurers, however, fears the indirect impact of Scotland leaving the UK following Brexit. Such an eventuality, he suggests, is 'the real political uncertainty for our sector', and one which poses a risk of fragmenting the domestic market.

Heavy Weather or Heavy Lifting? The Manufacturing Sector

The sector with the strongest pro-Brexit voice so far has been manufacturing. JCB, the world's third-biggest construction equipment firm, has been particularly outspoken. Its owner and chairman Anthony Bamford, Lord Bamford (a major donor to the Conservative Party) stated in May that: 'We are the fifth or sixth largest economy in the world. We could exist on our own – peacefully and sensibly.'

According to Bamford, Brexit could cut down on red tape for British business. The *Independent* suggests, political affiliation aside, two motivations for this stance. First, JCB makes most of its profits within the UK and it would not be substantively affected by a move away from the EU. Second, JCB could benefit from possible regulatory changes that might come with Brexit, particularly when negotiating deals with non-EU countries, such as the United States.

However JCB is still something of a voice in the wilderness within the wider manufacturing sector. In September 2014, 85 per cent of EEF members, from the UK manufacturing trade association, voted emphatically for continued EU membership, while only 7 per cent signalled their support for Brexit.

For two-thirds of the EEF, the most important benefit from EU membership is free trade, followed by simplification of regulation and overall economic growth. Brexit could hit the British manufacturing sector hard, with fewer EU highly skilled workers and the UK becoming a less attractive business destination for overseas investors.

Uncertainty around EU membership remains the biggest risk for the manufacturing sector. However, this uncertainty may be more short-term. Should a post-Brexit deal allow similar access to the EU single market, the long-term picture could be relatively unchanged, despite the initial period of disruption.

Everyday Business: Paying More for Energy, Food and Communication

Most of the big energy companies in the UK have addressed Brexit– all on the ‘Remain’ side. Their desire to maintain the overall shape of their European business is understandable. However, Brexit would not necessarily change much for the energy sector.

If the UK rejoined the European Free Trade Association (EFTA) or the EEA post-Brexit, it would probably remain part of the EU’s integrated gas and power markets. The UK government might lose its influence in decision-making in Brussels – the companies might not. They would still be able to lobby Brussels and national politicians of the Member States in which they are active.

The UK government would likely want to ensure that the power cables running from Britain to France and the Netherlands, and the gas pipelines connecting it to the Netherlands and Belgium, kept functioning smoothly in order to avoid shortages. To a certain extent, Brexit might in fact bring more freedom to British energy policy-making. The absence of EU energy regulation would allow the UK to prolong the life of some nuclear power plants and continue to let coal play a more central role.

Remaining in the EU implies heavy investment in renewables, which are supposed to produce 15 per cent of British energy – electricity, heat and transport combined – by 2020, according to EU rules. Renewable electricity generation would have to be raised to 30 per cent by 2020, from around 18 per cent at the moment.

However, more environmentally-friendly energy supplies are on the agenda in Britain, even if it left the EU. The last two governments both supported renewables. In any case, the climate targets set out in the Climate Change Act 2008 would remain legally binding (unless repealed by the UK Parliament).

Brexit might necessitate adaptations that could, according to a House of Commons Library report, result ‘in poorer security of supply through decreased interconnectivity to Europe, reduced harmonisation of EU energy markets or less investment into the UK by multinational companies’ – which might well translate into higher bills for customers.

Your mobile phone bill, restaurant check and hotel rate all are influenced – arguably lowered, in fact – by EU regulation. Many customers may not be aware of this – service and manufacturing companies are. Amongst others, the Scottish whisky industry is concerned by prospect of losses following Brexit. In fact, there is more to lose than market access: the Scotch industry depends on EU geographic indicators.

In order to be called 'Scotch', whisky must be distilled in Scotland and contain specific ingredients. Such provisions protect the 'Scotch' name for Scottish producers, both within the EU and in all third countries with which the EU has bilateral agreements on the matter. The European market accounts for around 40 per cent of Scotch sales, with France as the biggest national market within the EU – nearly twice as big as the US.

Britain's hospitality industry is equally concerned about losing its customer base. Peter Gowers, CEO of the hotel chain Travelodge, fears the UK might be 'sleepwalking into real danger if [the sector] doesn't stand up and be counted. If the result leads to it being more difficult for people to visit this country then we have a problem as an industry.'

Yet the sector has not always been the biggest supporter of the EU. Indeed, European regulation has repeatedly been seen as a 'bureaucratic nightmare', as evidenced by an open letter, signed by more than 100 leading chefs, restaurateurs and hoteliers, in March in an attempt to block EU allergen regulations from December 2014. The new rules require them to alert customers to the presence of 14 allergens in anything they serve, a measure perceived by many as disproportionately restrictive.

Nevertheless, the industry depends on Europe – if not on regulations, then its (travelling) citizens. However, it is becoming less dependent, as the number of people in the UK deciding to travel within the country has been increasing for some time. 'Stay-cations' boost the domestic economy and would not be affected by leaving the EU, given the potential for increased complexity in travelling to the EU.

The Involuntary Lobbyists

Next to those companies voicing their support for 'Leave' or 'Remain', a sizeable number of businesses has not been as eager to enter the debate. When asked to give their opinions, they usually take a neutral stance or refrain from disclosing their views.

Among these is the British telecommunications company Vodafone. Its head, Vittorio Colao, warned that uncertainty over Brexit could damage business and said that the EU digital market is necessary for remaining competitive with the US and China.

However, he rejected the call to arms of some business representatives, such as the then CBI President Sir Michael Rake, saying: 'I don't think it's the role of businesses to campaign if I'm honest. My role as CEO is to say on any issue, not just this one, what is in the interests of my customers and shareholders. I don't campaign, I don't take sides.'

While Colao articulated a position on Brexit despite reluctance, the supermarket chain Sainsbury's tried unsuccessfully to keep outside the debate altogether. A misunderstanding led Steven Woolfe MEP, UKIP's Financial Affairs Spokesperson, to wrongly claim on Twitter that Sainsbury's would financially support the 'Remain' campaign.

The situation began with press reports stating that David Sainsbury, the company's former chairman, would be involved in the campaign. Indeed, he donated 'hundreds of thousands of pounds of his own money to the cause of continued British membership of the EU'.

Sainsbury's experienced the effect of being even wrongly associated with either side of the Brexit debate – with angry customers protesting via social media, letters and phone calls, some declaring a permanent personal boycott against the supermarket chain. The company attempted to resolve the situation by declaring that it is '...apolitical. We would not get involved in this at all.'

Having told business to 'shut up' about Brexit in September, David Cameron may welcome such an approach. He went on to express disapproval of business representatives speaking out in favour of remaining in the EU, fearing it would jeopardise his renegotiation and could turn public opinion against staying in. After all, although Cameron has finally set out his conditions for the UK remaining in the EU, the results of the renegotiation are still months away.

In the early 1970s, when UK accession to the European Community was debated by European heads of state, the UK was considered by some a threat to the European market. At the time, this fear was based largely on the flexibility of sterling's exchange rates. Britain seemed better able to adapt to economic developments than other Member States, with their pegged currencies. It could possibly overtake them in competitiveness.

Today, the outlook has changed. On the one hand, major voices within the UK, in the public and private sectors, consider the European project a threat to British business and the economy, usually citing overregulation and entangling bureaucracy.

On the other, a visible majority of companies speaking out on Brexit generally express a clear pro-Remain opinion, couched in pro-business discourse. Their message seems simple: remaining in the EU is a winning recipe, at least for business – with its huge single market, uniform production and trading conditions and advantageous relationships with non-EU countries.

The question is whether economic arguments can convince a majority of voters to support EU membership coming from political, economic, social and even cultural perspectives. As Stephen Fidler writes in the *Wall Street Journal*, the EU has 'taken a battering – even in countries like France that have been at the heart of its development'.

This is certainly the case. The Eurocrisis and refugee crisis have made some see the EU as an ineffective and fragmented entity. These in turn have made it more difficult to make an argument to stay in the EU. Nevertheless, the majority of business players in the UK will likely continue to support EU membership, since they judge it to be in their own interest.

This article summarises a four-part series on the impact of leaving the EU for business in the UK published on the Canterbury Christ Church University Politics and International Relations Blog.

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Additional information:
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